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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. 218

WILLIAM A. ZEH, ISIDORE KRUPSKI, HAROLD E. GOODALE, ALFRED W. TOPPING, THOMAS H. WHITE, J. DWIGHT REEVE, JOHN P. KUJAWSKI, JOSEPH SIEMINSKI and WALTER TRUSKOLASKI,

Petitioners,

vs.

AEROGLADE CORPORATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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June 19, 1962.

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William A. Zeh, Isidore Krupski, Harold E. Goodale, Alfred W. Topping, Thomas H. White, J. Dwight Reeve, John P. Kujawski, Joseph Sieminski and Walter Truskolaski pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered on April 10, 1962 in a proceeding entitled *Aeroglide Corporation* v. *William A. Zeh, et al.*

Opinions Below

The opinion of the United States Court of Appeals for the Second Circuit is printed as Appendix "A" hereto. It is officially reported at 301 F. 2d 420. The opinion of the United States District Court for the Eastern District of New York, is printed as Appendix "C". It has not been officially reported.

Jurisdiction

The judgment of the United States Court of Appeals for the Second Circuit was entered on the 10th day of April, 1962 (infra Appendix A). The jurisdiction of this court is invoked under the provisions of 28 U. S. C. A. Section 1254 (1).

Question Presented

May a corporate director be *personally* liable in tort for conversion by voting for certain corporate action when in so voting he relies upon the advice of the corporation's attorney, and its general manager and without knowledge that the action which he thereby authorized may harm the rights of another?

Statement of the Case

Facts

The Suffolk Farmers Cooperative Association, Inc. purchased $84,922.96 worth of Aeroglide machinery. Before the assignment for the benefit of creditors, in 1957, it had paid for all but $13,302.51.

The twelve directors of the Cooperative were full-time farmers. They were unsalaried and, in addition to their function as directors, assisted in the sale of fertilizer, produce and other material handled by the Cooperative (R. a37)*. Because of the nature of this relationship to the Cooperative, they greatly relied upon their principal

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* The following references will be used herein:

App.—Appendices to this petition.

R. a—Record as printed in appendix to appellant's brief in court below.

R. b—Record as printed in appendix to appellees' brief in court below.

full-time officer and employee, Edwin Brangenberg, the General Manager (R. a38).

There were eleven separate purchases. All but one were negotiated directly between Brangenberg, on behalf of the Cooperative, and James F. Kelly, then, vice-president and, now, president of Aeroglide Corporation (R. a30-32). Brangenberg called Kelly and ordered machinery on behalf of the Cooperative (R. a30-32). Kelly sent a confirmation on the usual Aeroglide order form (R. a30). The one contract that was not entirely negotiated by Brangenberg was at his instigation (R. a30). He and Kelly prepared a series of nine proposals covering equipment which they proposed to provide for the Cooperative (R. a30). It was from these proposals that the Cooperative determined to purchase $61,000 worth of machinery. Thereafter, President Zeh and three other directors went to Raleigh, discussed machinery with Kelly, and Zeh signed the proposals (R. b2). The conditional bills were not recorded.

Prior to his becoming the principal full time officer and employee of the Cooperative, Mr. Brangenberg had been active in the farm machinery business for some ten years (R. a36). He had invented some of the machinery which was purchased by the Cooperative from Aeroglide (R. a40). He, also, had been associated with Aeroglide and was familiar with the purchase and sale of Aeroglide or similar farm machinery (R. a36).

Brangenberg, in the early winter of 1957, learned that the Springfield Bank for Cooperatives requested security for its loan to the Farmers Cooperative (R. a33). At the instigation of Brangenberg (R. a33) and the Coop's attorney Hubbard (R. a34), eight of the defendants voted for the mortgage. Zeh and Krupski signed the mortgage. Brangenberg and Hubbard arranged for the consent to mortgage (R. a38-39). At about that time, Brangenberg left the employ of the Farmers Cooperative and, soon thereafter, rejoined Aeroglide Corporation (R. a38).

In determining whether or not the chattel mortgage was feasible, attorney Hubbard, acting also on behalf of the Bank, searched the Suffolk County Clerk's records and, finding no liens on the farm machinery, advised the directors of the Cooperative that a chattel mortgage could be executed to secure the loan from the Springfield Bank (R. a35). Such a chattel mortgage (R. b5) was executed.

The Cooperative terminated its business in July, 1957 and it was stipulated (R. a36) that, if called, Hubbard would testify that:

> "At no time, until after July 3, 1957, was he advised by anyone that there was any conditional sales contract, nor was he advised that anyone claimed any of the personal property, except the Cooperative."

It was further stipulated (R. a40-41), that if the defendants were called, each of them would testify that he was unaware of the provisions in plaintiff's Exhibits 2 through 12, retaining title of the machinery in Aeroglide Corporation.

HISTORY OF THE LITIGATION:

The complaint served in the Spring of 1959 charged each of the defendants, all of whom had been directors of the Suffolk Farmers Cooperative Association, Inc., with having converted the interest of the plaintiff in certain farm machinery delivered to the Cooperative under a conditional bill of sale.

In their answer, the defendants allege that the title to the machinery vested in the Cooperative and that the alleged clause retaining title in Aeroglide was ineffective. The directors, also, alleged that Aeroglide was estopped to contend that it was a contract of conditional sale and that the defendants, as directors of the corporation, were not, personally, responsible for the tort of the corporation since

they had no knowledge that the machinery was not that of the Cooperative.

The trial judge found: that the conditional sales contract was valid, that the directors were charged with constructive knowledge of the existence of the clauses retaining title in Aeroglide, that the participation of the defendants in the execution of the mortgage rendered them jointly and severally liable in conversion.

Decision of the Court of Appeals

Upon appeal to the United States Court of Appeals for the Second Circuit, the court in making its decision and judgment affirmed in part and reversed in part. In affirming, the court found that 8 of the 11 directors had attended the meeting which authorized the mortgage. It further found that a 9th director, Isidore Krupski, treasurer, had signed the chattel mortgage. These nine defendant directors were found to be joint tort feasors in the tort of conversion because eight had voted for the mortgage and the 9th one had signed it. The court further found that two of the directors, Robert W. Gillespie and Joseph P. Celic, had neither formally authorized the mortgage as a director nor signed it as an officer. The appellate court also found that these two men as stockholders but not as directors, had signed a consent to mortgage, which consent was necessary before the mortgage could be voted by the Board of Directors. Regardless of their consent as stockholders, the Court of Appeals found that since they had not participated as directors, they were free of any liability.

Reasons for granting the writ

The writ should be granted because the rule in this decision is one of personal liability predicated upon mere physical participation by a director in corporate acts which constitute a tort; this is in direct conflict with the 1961 Second Circuit Court of Appeals decision in *Armour and*

Company v. *Joseph P. Celic*, et al., 294 F. 2d 432 where the liability is predicated upon the "culpable implication" of the director.

Specifically, we submit that the decision below is unprecedented and erroneous in the following respects:

1. The *Aeroglide* rule casts a director in the role of an insurer of title four corporate acts in which he participates.

2. The *Aeroglide* rule in no way provides for good faith, reasonableness of action or inadvertance.

3. The *Aeroglide* rule determines that a corporate director in relying upon the advice of corporate counsel and its professional staff does so at his peril.

4. The *Aeroglide* rule places a premium upon absence, faithlessness and dereliction of duty.

5. The *Aeroglide* rule encourages dummy directors and discourages attendance at director's meetings.

6. If the *Aeroglide* rule is to be the law of the Circuit, who but a fool, a knave or a bankrupt will be a corporate director?

We, respectfully, submit, that the propositions established by the decision below are so novel and so drastic in their potential effect on the business and economic life of this country, that it is in the public interest that this court review this decision, and put at rest the doubts which it casts upon the duties and liabilities of myriad corporate directors.

Argument

The *Aeroglide* case is an action in conversion. The *Armour* case is also an action in conversion. In 1958, the attorneys for the defendants in the *Armour* action made a motion to make the Armour complaint more definite and certain and in refusing to grant the motion, Judge Abruzzo said in a memorandum printed herein as Appendix "E"

(App. 22a) that "The complaint pleads a plain case of conversion . . .".

The *Aeroglide* case subjects to liability a director who physically participates in the actions which result in the conversion. The *Armour* case subjects to liability only that director who is "culpably implicated" in the acts which result in the conversion. These two rules from the same Circuit Court, determined within 8 months of the other, dealing with the same tort involving the same individual directors-defendants, are in conflict and as such constitute an appropriate instance where this Court may grant appellate review. *Dickinson* v. *Petroleum Conversion Corp.*, 338 U. S. 507 (1947); *Maggio* v. *Zeitz*, 333 U. S. 56 (1948); *John Hancock Insurance Company* v. *Bartels*, 308 U. S. 180 (1939).

The rule of the *Armour* case is set forth at 294 Fed. 2d 432, 438 where the Court discussed the Cooperative's tortious misappropriation of Armour property:

> ". . . If, as we have found, the Cooperative tortiously misappropriated plaintiff's property by disbursing its monies to persons other than plaintiff and by exchanging its fertilizer for produce, then the defendants who are *culpably implicated* must be held accountable wholly apart from whether their action constitutes a technical conversion.", (emphasis added)

If the *Armour* rule, which requires a finding of culpability; were applied to the facts of the *Aeroglide* case, the defendants, therein, would be exculpated. The *Armour* rule has two parts; first, it requires a finding that the allegedly tortious director was implicated or participated in the acts which constituted a conversion and, secondly, in so participating, his actions were culpable.

Culpable means "criminal", "reckless", "gross". It imparts a "disregard of consequences and an indifference of the rights of others". *People* v. *Grogan*, 260 N. Y. 138, 144 (1932). Black's Law Dictionary, 4th edition, page 454, defines culpable as 'blameable, censurable, . . .".

Rather than being culpable in their actions and in their management of the corporation with respect to determining whether or not to execute the mortgage, the directors in *Aeroglide* were most prudent. In determining to execute the mortgage, the directors sought the advice of the corporate attorney and its professional general manager. As a matter of law, these directors were justified in that reliance. In *Litwin* v. *Allen*, 25 N. Y. S. 2d 667 (1940 not otherwise reported), the court stated, at page 719:

> "Directors have a right in forming their conclusions to rely upon information furnished and conclusions expressed by the management. Lord Halsbury said in holding a bank director not negligent for approving advances on improper security and the payment of dividends out of capital in honest reliance on the statements of the chairman and manager of the bank (*Dovey* v. *Cory*, (1901) App. Cas. 477, 486): 'I cannot think that it can be expected of a director that he should be watching either the inferior officers of the bank or verifying the calculations of the auditors himself. The business of life could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to details of management.'"

In *Gilbert* v. *Burnside*, 197 N. Y. S. 2d 623, at 633 (1959, not otherwise reported), rev'd on other grounds 13 A. D. 2d 982, 216 N. Y. S. 2d 430 (1961) the court stated a corollary principle:

> "It is generally held that where directors seek legal advice and honestly act under it, they are protected from personal liability." Citing: *Blaustein* v. *Pan-American Petroleum & Transportation Co.*, 293 N. Y. 281 (1944); *Bailey* v. *Babcock*, 241 Fed. 501 (W. D. Penna 1915); *Uffelman* v. *Boillin*, 19 Tenn. App. 1, 82 S. W. 2d 545 (1935); *Bates Street Shirt Co.* v. *Waite*, 130 Me. 352, 156 Atl. 293 (1931).

The Second Circuit's *Armour* rule of "culpable implication" is not new. It, correctly, synthesizes the majority rule as to a director's personal liability for a corporate conversion and, in part, is based upon the following deci-

sions: *Santa Barbara* v. *Avalone and Miele, Inc.*, 270 N. Y. 1 (1936); *Darling and Company* v. *Fry* 24 S. W. 2d 722 (Mo. App. 1930 not otherwise reported); *Refrigeration Discount Corp.* v. *Catino*, 330 Mass. 230, 235-236, 112 N. E. 2d 790, 793-794 (1953); *American Agricultural Chemical Co.* v. *Barnes Co., Inc., et al.*, 28 F. Supp. 73, 75 (E. D. So. Carolina 1939).

Santa Barbara v. *Avalone and Miele, Inc.*, 270 N. Y. 1 (1936), involved a situation where certain moneys were delivered to a New York corporation for transmittal to an Italian bank. Instead of transferring the funds to the Italian bank, the moneys were put in a "Dollar Account" of the defendant corporation. Thereafter, the moneys were drawn out of this account by the individual director-defendants by means of checks signed by them but used for payment of expenses of the corporation. There was no finding that any of the individual defendants had appropriated any funds for their own use. One of the defendants Miele signed the checks on the account without knowledge of the purpose of the deposit of the funds. The court, in denying that Miele was, individually, liable, stated:

> "But Miele may be held liable as an active participant in the wrong of the corporation only if he participated as agent in the withdrawal of the money of the plaintiffs from the lire account, or had knowledge that the moneys of the plaintiffs in that account had been placed in the 'Dollar Account' nor is there any finding that Miele participated in the directions which transferred these moneys from the lire account to the 'Dollar Account'. . .
>
> "* * * It is true that Miele was one of the signers of the checks withdrawing the credit arising from the deposit of the moneys belonging to the plaintiffs in the dollar account but he had no knowledge that the moneys were other than assets of the Avalone Corporation, and therefore, available for the purposes of its business." (at pp. 6 and 7).
>
> ". . . No authority has been brought to our attention which would justify our holding this defendant-appellant guilty of conversion".

Santa Barbara was cited with approval in *Refrigeration Discount Corp.* v. *Catino*, et al., 330 Mass. 230, 112 N.E. 2d 790, at 794 (1953). The Massachusetts Supreme Judicial Court found that one officer of the corporation was liable in conversion because he had, knowingly, participated in the wrong, while the second defendant, Mr. Chase, was exonerated since he had no wrongful knowledge even though he did physically participate in acts constituting a conversion.

This rule as to a director applies equally well to an officer or manager. We are fortunate that we have a very close analogy in *Darling & Company* v. *Fry*, 24 S.W. 2d 722 (Mo. App. 1930 not otherwise reported) which, is a principal United States authority, dealing with the liability of officers and directors of farmer associations.

In the Darling case, plaintiff, a manufacturer of fertilizer, entered into a contract with a farmer's association. Some months later, defendant became employed by said association as manager and executive officer. Soon thereafter, plaintiff sold fertilizer to the association after negotiations with defendant-manager. Defendant, thereafter, sold the fertilizer in the normal course of the association's business, using the funds received, admittedly the property of the plaintiff, for other purposes—but not for his own benefit.

The Court absolved the defendant-manager of conversion, stating at page 723:

> "When the proceeds of a sale of goods, consigned to a corporation to be sold on commission, have been intentionally misapplied, the officers in control of the fund who have knowingly participated in the wrong are individually liable, and of course defendant's liability does not depend upon his having derived any personal benefit from the alleged conversion.
>
> "But the manager of a corporation is not personally liable to one who consigns goods to it under a contract making it his agent to sell and account, for mingling the proceeds of sales with the company's

general funds and failing to account, where it is not shown that he had actual knowledge of such contract, and did not participate in the alleged wrongful act."

The rule in the *Darling & Company* case was followed in *American Agricultural Chemical Co. v. Barnes Co., Inc., et al.*, 28 F. Supp. 73, 75 (D.C.E.D. So. Carolina 1939).

The rule in the *Aeroglide* decision, in addition to being in conflict with the *Armour* rule, is illogical and arbitrary; a strict adherence, thereto, will cause a heavy burden upon the commerce of the nation.

In *Miller v. Hope*, 2 Shaw App. Cas. 125 (1824), the judge had denounced the conduct of counsel and had been sued for it. Lord Stair said, with respect to such a suit, that if a judge were to be subjected to such liability, "No man but a begger or a fool would be a judge".

Lord Stair's reasoning is equally applicable to the rule of liability here presented for review. Directors of all major corporations must rely upon the advice of the professional staff as well as the advice of corporate counsel as to matters requiring expert knowledge or else no decision could ever be made consistent with the fast pace of commerce. *Litwin v. Allen*, 25 N.Y.S. 2d 667 (Sup. Ct. 1940, not otherwise reported; *International Paper Co. v. Gazette Co.*, 182 Mass. 578, 66 N.E. 636 (1903).

By virtue of the *Aeroglide* decision, a director takes the advice of corporation counsel at his personal peril. Such a rule, necessarily, states that if the attorney has made an error of fact or judgment and a corporate conversion occurs, the director is personally responsible. If this be so, who but a knave or a fool or a bankrupt will wish to be a director?

Section 27 of the General Corporation Law states that the business of the corporation shall be managed by its Board of Directors. It is also true that a figure-head director is not tolerated in New York state. A director who

accepts the post must attend meetings and vote. *Cavanaugh v. Commonwealth Trust Co.*, 223 N.Y. 103 (1918); Hornstein, *Corporation Law and Practice*, West Pub. Co., 1959, Vol. I, pp. 547.

Such is the public policy of the State of New York, yet the court in the Aeroglide decision found liability against those directors who attended the directors' meetings while exculpating those directors who knew of the vote for the mortgage, but chose that day to be absent. The practical implications of the decision are that it places a premium upon shirking a duty and a penalty upon performing a duty. Under this theory of law, a knowledgeable director will absent himself, and sterilize board proceedings.

Conclusion

The ruling below injects a harsh and arbitrary rule into corporate procedure. This petition for a writ of certiorari should, therefore, be granted.

Respectfully submitted,

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